United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

76-7156
76-7170

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P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,
Plaintiff and Cross-Appellant,

against

CHESTNUTT CORPORATION,
Defendant-Appellant,

and

AMERICAN INVESTORS FUND, INC.,
Nominal Defendant.

UNITED STATES COURT OF APPEALS
FILED
AUG 1978
R. FUSARO, CLERK
SECOND CIRCUIT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR PLAINTIFF AND CROSS-APPELLANT

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BRIEF FOR PLAINTIFF AND CROSS-APPELLANT

Counter-Statement of the Issues

1. Was the District Court correct in finding liability in this shareholder's derivative action on behalf of a mutual fund?

2. Should the 1974 damage award be increased?

Proceedings Below

This shareholder's derivative action on behalf of a mutual fund was tried, without a jury, in the United States District Court for the Southern District of New York

before the Honorable Charles L. Brieant. The trial and later proceedings respecting damages resulted in a judgment in favor of plaintiff and on behalf of the mutual fund of $76,672 against Chestnutt Corp., the investment adviser to the mutual fund. The Court's decision is reported at 402 F.Supp. 1318 and is reproduced in the Joint Appendix filed by defendants at pp. A-42 through A-59.

Statement of the Case

This is a derivative action on behalf of American Investors Fund, Inc. ("AIF"), a New York corporation, registered pursuant to the Investment Company Act of 1940 ("the Act") as an open-end diversified investment company, and commonly known as a mutual fund. The defendants below were Chestnutt Corp., the investment adviser to AIF and George A. Chestnutt, Jr., the principal shareholder of Chestnutt Corp. AIF, on whose behalf the action is brought, is a nominal defendant.

The essence of the claim was a wrongful mid-term change in the advisory agreement under which Chestnutt Corp. served as an investment adviser to AIF. The change increased a guaranteed annual expense limitation for AIF from 1% of AIF's average monthly net assets to 1½% of AIF's average monthly net assets. The effect of the increase was to deprive AIF of a refund or rebate, from Chestnutt Corp. for the amount that AIF's expenses exceeded 1% for the period in issue. The Court below found for plaintiff on the issue of liability and concluded that the rebate would have been $76,672. Judgment was entered in that amount against Chestnutt Corp.

Chestnutt Corp., or its predecessor, had served as investment adviser to AIF since AIF's formation in 1957. In the spring of 1973, it was serving as investment adviser to AIF pursuant to an advisory contract dated as of September 1, 1972 ("Old Advisory Contract"). A copy of the Old

Advisory Contract is annexed as Exhibit 1 to this Brief. The Old Advisory Contract, by paragraph 11, provided for a term of two years from September 1, 1972, but could be sooner terminated by either AIF or Chestnutt Corp. on 60 days written notice.

Under the Old Advisory Contract, Chestnutt Corp. agreed to provide AIF with, among other things, research, statistical and advisory services, office space, clerical and mailing services and payment of all AIF executive salaries. For this, Chestnutt Corp. was to receive, as an advisory fee, a fixed percentage of AIF's average monthly net assets. The specific fee payable under the Old Advisory Agreement was .8 of 1% on the first $50 million of AIF's average monthly net assets, .6 of 1% on the next $50 million, .4 of 1% on the next $200 million, .35 of 1% on the next $200 million and .3 of 1% on all amounts in excess of $500 million. This advisory fee, however, was subject to a 1% expense limitation. The expense limitation required Chestnutt Corp. to rebate to AIF all amounts by which the expenses of AIF, net of interest and taxes but including the advisory fee, exceeded 1% of AIF's average monthly net assets for any year.*

In the spring of 1973, while the Old Advisory Contract had more than one year to run, defendants Chestnutt Corp. and George A. Chestnutt, Jr. acted to replace the existing agreement with a new advisory contract. The new agreement ("New Advisory Contract") was identical in all re-

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* The Old Advisory Contract, after setting out the compensation to Chestnutt Corp., stated:

> "provided, however, that the annual fee of the Investment Adviser shall not be more than an amount which, when added to the other charges of the Corporation (exclusive of interest and taxes) shall result in such charges per annum to the Corporation inclusive of the fee of the Investment Advisor (but exclusive of interest and taxes) of 1% of the value of the Corporation's average monthly net assets for any year."

spects to the Old Advisory Contract except that the expense limitation was increased from 1% to 1½% of average monthly net assets.

Plaintiff challenged the increase in the expense limitation on three specific and separate grounds. First, plaintiff asserted that the increase in the expense limitation resulted from defendants' breach of fiduciary duty since a benefit for AIF was given up for which no consideration was received. Second, plaintiff asserted that the New Advisory Contract was void as not having been approved in compliance with Section 15(c) of the Act, 15 U.S.C. § 80a-15(c).* Plaintiff asserted that the directors of AIF did not request and evaluate and Chestnutt Corp. did not furnish information reasonably necessary to evaluate the increase in the expense limitation. Third, plaintiff challenged the propriety of the proxy statement issued by AIF to its shareholders in connection with the vote on the New Advisory Contract.

The Court found for plaintiff on two separate and independent grounds. The Court first found that defendants indeed failed to comply with the requirements of Section 15(c) of the Act in providing information reasonably necessary to the issue. The Court, however, did not find

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* Sec 15(c). In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.

this violation standing alone to be a sufficient basis to void the New Advisory Contract. The Court considered the violation of Section 15(c) and the attendant conduct of defendants and concluded that defendants' conduct was a breach of fiduciary duty in violation of Section 36(b) of the Act, 15 U.S.C. Section 80a-35(b). The Court also concluded that the Proxy Statement used to solicit votes in favor of a New Advisory Contract was deficient. The Court, after additional post-trial proceedings on damages, entered judgment against Chestnutt Corp. and in favor of AIF for $76,672.

ARGUMENT

Defendants Breached Their Fiduciary Duty to the AIF Shareholders

The Court below concluded that defendants breached their fiduciary duties to AIF by acting to impose the increased expense limitation on AIF. The Court, in reaching this conclusion, considered both what the increase meant to AIF as well as how the increase was effectuated. At trial, the Court heard testimony of AIF directors Greene, Chestnutt, Fowler, Ulrich and Currier and testimony of Cram, the AIF attorney who worked on the proxy statement. The Court concluded:

> "The disinterested directors gave only the most cursory attention to the expense ratio increase, never considered opposing Mr. Chestnutt's suggestion or asking for further information regarding Chestnutt Corporation's finances." (A-50).
>
> • • •
>
> "The increase effective September 1, 1973 from 1% to 1½% in the expense ratio limitation was obviously beneficial to Chestnutt Corporation. Nothing in the record indicates any benefit flowing to the Fund from such increase." (A-52).
>
> • • •

> "Mr. Chestnutt's claim that unless the increase were approved, Chestnutt Corporation's continued existence and capacity to function as adviser to the Fund would be threatened, is unsupported." (A-52).
>
> * * *
>
> "However, none of the directors made any attempt to determine whether Chestnutt Corporation was in financial difficulty, or intended, absent the modification, to withdraw as adviser." (A-51).

And, as stated, the Court found a violation of Section 15(c) of the Act in that information reasonably necessary to evaluate the New Advisory Contract was neither requested by the directors nor furnished to them by Chestnutt Corporation. The Court specifically considered a table of information prepared by director Ulrich and circulated among the AIF board members, but concluded it was insufficient on the Section 15(c) issue. (A-49).

The above-quoted segments of the Court's Findings and Conclusions are only certain of the Court's rulings which supported the breach of duty claim. Defendants, on appeal, seek to reargue the issue by urging that the AIF directors were kept generally informed of events affecting AIF. (Defendants' Brief, pp. 8-11). Defendants, however, make no showing that the Court's findings on the facts were clearly erroneous in reaching the conclusions it did.* Instead, defendants merely point to certain facts before the AIF board which relate to AIF, or the mutual fund industry generally, but not the specific problem of the probable rebate AIF was eligible to receive before the expense limitation increase.

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* Rule 52(a) of the Federal Rules of Civil Procedure states:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

See also *Hedger* v. *Reynolds,* 216 F.2d 202, 203 (2d Cir. 1954) and *Langford* v. *Chrysler Motors Corp.,* 513 F.2d 1121, 1127 (2d Cir. 1975).

Defendants still do not and cannot point to evidence considered by the AIF board as a whole respecting (1) the probability of a rebate; (2) the expected amount of such rebate; and (3) the expected harm to AIF and/or Chestnutt Corp. if Chestnutt were compelled to meet its contractual commitments to AIF by paying such rebate. It was Chestnutt Corp.'s failure to provide and the board members' failure to request information of this type that led the Court to conclude that fiduciary duties were breached when defendants acted to have AIF forego the imminent rebate under the existing 1% expense limitation. The Court's findings under the record before it and before this Court are sound and should be affirmed.

Defendants' Brief, while disputing the factual findings of the Court below, makes no argument as to the sufficiency of the Court's conclusions of law respecting the breach of duty. Defendants apparently concede, as they must, that the factual findings of the Court respecting the conduct of defendants require a holding that defendants breached their fiduciary duty to AIF and its shareholders. We rely on the Court's discussion below respecting this point. See A-52, A-53.

The Proxy Statement Was Materially False and Misleading

The Court below found that the Proxy Statement used to solicit AIF shareholder approval of the New Advisory Contract was materially false and misleading. The Court focused on the only paragraph in the Proxy Statement dealing with the sole issue before the shareholders, i.e., the proposed increase in the expense limitation, and concluded that paragraph deficient on two grounds. The misleading paragraph in its entirety is as follows (emphasis added by the Court below):

> *"As a result of cost increases over which neither the Fund nor the Adviser can exercise control,* the Fund

and the Adviser have determined that the 1% annual expense ratio limitation in the current Investment Advisory Agreement shall be increased to 1½%. No increase in the fees paid or payable to the Adviser is proposed. The aggregate of annual operating costs, including the fee of the Adviser, will be limited to 1½% of average monthly net assets in the contract. Heretofore, the Advisory Contract required the Adviser to reimburse the Fund to the extent that total annual expenses (exclusive of interest and taxes) exceeded 1% of average monthly net assets. Under the new agreement, no reimbursement from the Adviser would be required unless and until total annual expenses of the Fund (again, excluding interest and taxes) exceeded 1½% of average monthly net assets. The Investment Advisory fee schedule would not be changed under the new agreement; however, the higher allowable expense ratio limitation would benefit the Adviser by reducing the risk that some or all of the advisory fee would have to be reimbursed to the Fund due to an increase in rates for other expenses or changes in the average account size of American Investors Fund shareholders. *No higher fees or costs would have been incurred by the Fund had the proposed new Agreement been in effect in 1972.*"

The Court concluded as follows (A-54, A-55):

"With regard to the first statement italicized above, the shareholders should have been told it was the combination of decreasing net asset value and increasing expenses which resulted in a 'risk' that the adviser would have to reimburse the Fund. The paragraph as a whole, particularly with the addition of the last sentence, is misleading. That a refund might be due in 1973 if the old contract remained in effect for the balance of its agreed term of two years was material 'in

> the sense that a reasonable investor might have considered (it) important,' *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-54 (1972); *Mills* v. *Electric Auto-Lite*, 396 U.S. 375 (1970); *Schlick* v. *Penn-Dixie Cement Corporation*, 507 F. 2d 374 (2d Cir. 1974), in deciding whether to vote in favor of ratification of the proposed new advisory contract.
>
> The quoted paragraph gives no indication whatever that a refund was ever even a remote possibility, under any likely set of foreseeable circumstances, including rejection of the proposed new agreement. In this regard, it was misleading, and false. There is no doubt that Mr. Chestnutt and the other interested directors thought a rebate was likely, or they would not have sought an increase in the expense ratio."

Defendants urge that adequate disclosure was made since the quoted paragraph contained a reference to a "reduced risk" of a refund to AIF. The Court, however, considered this part of the offending paragraph since the Court specifically considered "the paragraph as a whole." The Court found Mr. Chestnutt thought a rebate was likely, as the record amply demonstrated. This being so, the AIF shareholders should have been told of the fact and then squarely asked if they would vote to forego that benefit for no consideration from their investment adviser

Defendants seek relief from the Court's ruling by saying the reference to 1972 results at the end of the paragraph, specifically found offensive by the Court, was included to conform to an SEC request. Defendants cannot, in good faith, pursue such a defense since the defendants specifically disregarded an SEC request for inclusion in the Proxy Statement when the requested matter offended their sensibilities. The SEC requested inclusion in the Proxy Statement of the apparently embarrassing fact that AIF paid a higher fee to its adviser than most funds. (A-53, 54, footnote 7). Defendants refused to include this

fact, which would obviously be material to an investor considering whether to insist on a rightful claim of refund of that higher advisory fee. This is particularly so since AIF, under Chestnutt Corp.'s handling, had performed so dismally. (A-48, footnote 5).

Defendants cite *TSC Industries, Inc., et al.* v. *Northway, Inc.*, —— U.S. ——, CCH Fed. Sec. L. Rptr., Current Decs., ¶ 95,615 (Sup. Ct. 1976), the Supreme Court decision respecting the materiality of deficiencies in proxy material, decided subsequent to the decision below. The Supreme Court sharpened the definition of materality by holding: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." No serious argument can be made that the reason for the requested increase in expense limitation or the likelihood of the refund to AIF that would be surrendered were matters that a reasonable shareholder would not consider important. It is, indeed, difficult to state factors more relevant to the issue put before the shareholders than these points, which the Court found deficiently discussed in the Proxy Statement.

Damages for 1974 Should Be Increased

The Court below entered judgment for plaintiff, in favor of AIF, and against Chestnutt Corp. for $76,672. This sum represented the total of the 1973 refund to which AIF was entitled of $18,330 and AIF's rightful refund for the first eight months of 1974 in the amount of $58,342. Plaintiff cross-appeals to challenge the 1974 calculation. Plaintiff computes damages for the eight-month period used by the Court at $144,507, which increases the amount of the judgment to $162,837.

Plaintiff asserts that the Court below made one fundamental error in computing the rebate for the first eight months of 1974. (A-59). That is, the Court disregarded *all* July-August 1974 expenses except those for the redemp-

tion program ($26,045.82) and advisory fee ($104,851.00).* There is no reason or logic for such exclusion.

Annexed hereto as Exhibit 2 is a post-trial exhibit prepared by defendants and submitted to the Court. Defendants, in this exhibit, set forth the following items, among others, necessary to calculate the 1974 refund:

1. $800,204—AIF's expenses, net of interest and taxes, for the first 6 months of 1974. Exhibit 2, paragraph 2. The Court used this also. (A-50).

2. $1,304,812—1% of AIF's average monthly net assets for 1974 or the 1% expense limitation for all 1974. Exhibit 2, paragraph 13.

3. $869,975—Eight-twelfths of the $1,304,812 1% expense limitation. Exhibit 2, paragraph 13. The Court inadvertently used $869,758.80. (A-59). The corrected number reduces plaintiff's claim by $115.20.

4. $325,768—Third Quarter AIF expenses of $329,896 minus interest and taxes of $4,128. Exhibit 2, paragraph 15.

Using the foreging, all from defendants' exhibit, and the Court's format in computing 1974 damages, damages for 1974 are computed as follows:

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* Plaintiff does not challenge the 1973 calculation or otherwise challenge the 1974 calculation.

$ 800,204	Expenses for first six months on accrual basis, net of interest and taxes
217,178	Two-thirds of 1974 third quarter expenses, net of interest and taxes
$1,017,382	Total expenses, net of interest and taxes, first eight months of 1974
– 3,000	Less allowance for legal expenses
$1,014,382	
869,875	Eight-twelfths of the $1,304,812 1% expense limitation for 1974
$ 144,507	Rebate for 1974

In arriving at the above, plaintiff prorated the AIF third-quarter expenses (July, August and September) of $325,768, net of interest and taxes, to arrive at $217,178. This two-thirds proration is precisely what the Court did for the third quarter redemption expenses of $26,045.82 (⅔ x $39,068.73) and third quarter advisory fee of $104,851.* (A-59).

The Court below, upon plaintiff's motion for reargument, refused to increase the 1974 award in accordance with the argument made herein. See Endorsement, A-62, wherein plaintiff's motion was denied. The Court therein, however, did state its "serious misgivings as to the correctness of the computation of damages awarded" indicating an increased amount was "not inconceivable."

This Court has before it, as did the Court below, financial information supplied by defendants (Exhibit 2 at-

* See Exhibit 2, paragraph 15. The third quarter advisory fee paid in October 1974 was $157,277. Two-thirds of that is the $104,851 used by the Court below.

tached) and upon which plaintiff relies. Plaintiff, using (a) defendants' data, (b) the Court's period for computation of damages, and (c) the proration approach used by the Court itself, has established the measure of damages for 1974 in the amount of $144,507. This Court should endorse this computation and remand for entry of judgment of $162,837.

Conclusion

For the foregoing reasons, plaintiff respectfully contends that the decision of the Court below should be affirmed as to the liability of Chestnutt Corp. to AIF and that the Court be directed to enter judgment against Chestnutt Corp. and in favor of AIF for $162,837.

Respectfully submitted,

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Attorney for Plaintiff and Cross-Appellant
99 Park Avenue
New York, New York 10016

Attorneys for Plaintiff

RONALD LITOWITZ
EDWARD A. GROSSMANN
Of Counsel

Exhibit 1

INVESTMENT ADVISORY AGREEMENT

between

AMERICAN INVESTORS FUND, INC.

and

CHESTNUTT CORPORATION

AGREEMENT made as of September 1, 1972, by and between AMERICAN INVESTORS FUND, INC., a corporation organized and existing under the laws of the State of New York (herein called the "Corporation") and CHESTNUTT CORPORATION, a corporation organized and existing under the laws of the State of Connecticut (herein called the "Investment Adviser").

WHEREAS, the Corporation is engaged in business as an open-end management investment company, and is registered under the Investment Company Act of 1940, and

WHEREAS, the Investment Adviser is engaged in the business, among other things, of rendering research, statistical, and advisory services to investors, and is registered under the Investment Advisors Act of 1940.

NOW, THEREFORE, in consideration of the premises and of the mutual promises hereinafter set forth, the parties hereto agree as follows:

1. The Corporation hereby retains the Investment Adviser to render research, statistical and advisory services to the Corporation, and to assist and guide the officers and directors of the Corporation in the investment administration of its resources, so long as this agreement shall remain in effect.

2. The Investment Adviser hereby accepts such retainer and agrees to render such services to the best of its ability.

3. The Corporation will, from time to time, deliver to the Investment Adviser detailed statements of the investments and resources of the Corporation and information as to its investment problems.

4. The Investment Adviser shall, from time to time, to the extent reasonably required in the conduct of the business of the Corporation and upon its request, make available to the Corporation research, statistical, and advisory reports and charts upon the industries, businesses, corporations, and securities as to which such requests shall be made, whether or not the Corporation shall at the time have any investment in such industries, businesses, corporations, or securities.

5. The Investment Adviser shall, from time to time, taking into consideration the investment requirements of the Corporation, recommend to the Corporation that it adopt specified investment policies, or that it purchase, sell, retain, or exchange designated securities; and the Corporation, acting on such recommendations, may, but shall not be required to, adopt such policies or purchase, sell, retain, or exchange such securities.

6. The officers and advisory personnel of the Investment Adviser shall be available at all times upon reasonable notice for consultation with the directors and officers of the Corporation in connection with any of the Corporation's investment problems.

7. The Investment Adviser shall furnish to the Corporation such office space as may be necessary for the suitable conduct of the Corporation's business and all necessary light, heat, telephone service, office equipment and stationery and stenographic, clerical, mailing and messenger service in connection with such office; and pay the salaries of all of the Fund's executives, and pay all promotional, travel, and entertaining expenses relating to Fund sales.

8. The Investment Adviser shall not be liable for any loss sustained by reason of the adoption of any investment policy or the purchase, sale, or retention of any security on the recommendation of the Investment Adviser, whether or not such recommendation shall have been based upon its own investigation and research or upon investigation and research made by any other individual, firm, or corporation, if such recommendation shall have been made and such other individual, firm, or corporation shall have been selected with due care and in good faith; but nothing herein contained shall be construed to protect the Investment Adviser against any liability to the Corporation or its security holders by reason of wilful misfeasance, bad faith, or gross negligence in the performance of its duties or by reason of its reckless disregard of its obligations and duties under this Agreement.

9. The Corporation agrees to pay to the Investment Adviser and the Investment Adviser agrees to accept as full compensation for all services rendered by the Investment Adviser hereunder for each of the Corporation's fiscal quarters on the last day of each quarter, a fee in an amount determined by applying the following quarterly rates to the value of the Corporation's net assets at the end of each calendar quarter:

Quarterly Rate	Equivalent Annual Rate	Net Assets of the Corporation
0.2 of 1%	0.8 of 1%	on the first $ 50 million
0.15 of 1%	0.6 of 1%	on the next $ 50 million
0.1 of 1%	0.4 of 1%	on the next $200 million
0.0875 of 1%	0.35 of 1%	on the next $200 million
0.075 of 1%	0.3 of 1%	on net assets in excess of $500 million

provided, however, that the annual fee of the Investment Adviser shall not be more than an amount which, when added to the other charges of the Corporation (exclusive of interest and taxes) shall result in total charges per

annum to the Corporation inclusive of the fee of the Investment Adviser (but exclusive of interest and taxes) of 1% of the value of the Corporation's average monthly net assets for any year. For the first quarter in which this Agreement shall be in effect, the foregoing computations shall be made as if this Agreement was in effect for the entire quarter. For the quarter and the year in which this Agreement terminates, there shall be an appropriate proration in the basis of the number of days that this Agreement is in effect during the quarter and the year respectively. If, pursuant to the Certificate of Incorporation of the Corporation, the net assets are not required to be determined on any particular business day, then for the purpose of the foregoing computations the net assets last determined shall be deemed to be the net assets as of the close of business on that day.

10. The Investment Adviser agrees that it shall not take any long or short position in the stock of the Corporation but this prohibition shall not:

(a) prevent the Investment Adviser, acting as or for the distributor of the stock of the Corporation, from purchasing shares of such stock, if orders to purchase such shares are placed by the distributor upon receipt of purchase orders for such shares and are not in excess of the purchase orders received by the distributor;

(b) prevent the Investment Adviser, acting as or for a distributor of the stock of the Corporation, from maintaining a market for such stock in the capacity of agent for the Corporation; or

(c) prevent the purchase by or for the Investment Adviser of shares of the stock of the Corporation at the price at which such shares are available to the public at the moment of purchase; provided that such purchase be made for investment purposes only.

11. This agreement shall remain in effect for a period of two years from the date hereof unless sooner terminated as hereinafter provided. This agreement shall continue in effect from year to year thereafter, subject to the provisions for termination and all of the other terms and conditions hereof, but only so long as such continuation shall be specifically approved at least annually by a majority of Directors who are neither parties to such contract nor "interested persons" of any such party, and either (a) the Board of Directors of the Fund or (b) by a vote of holders of a majority of the outstanding shares of the Fund.

12. Nothing in this agreement shall prevent the Investment Adviser or any director, officer or employee thereof from acting as Investment Adviser for any other person, firm, or corporation and shall not in any way limit or restrict the Investment Adviser or any of its directors, officers or employees from buying, selling or trading in any securities for its or their own accounts or for the accounts of others for whom it or they may be acting.

13. This agreement cannot be amended, transferred, assigned, sold or in any matter hypothecated or pledged (herein called "amended, assigned or pledged"); in the event of cancellation or expiration of this agreement or other management contract, no new management contract shall become effective without the affirmative vote of holders of a majority of the shares of the Fund. This agreement shall automatically and immediately terminate in the event it is amended, assigned or pledged.

14. This agreement may be terminated (a) by the Corporation, upon sixty (60) days' notice in writing to the Investment Adviser without the payment of any penalty, provided such termination be authorized by resolution of the Board of Directors of the Corporation or by vote of holders of a majority of the shares of the Fund; and (b) by the Investment Adviser, upon sixty (60) days notice in writing to the Corporation, likewise without penalty.

15. For the purpose of this agreement, the "affirmative vote of holders of a majority of the shares of the Fund" means the affirmative vote, at a duly called and held meeting of shareholders of the Fund, (a) of the holders of 67% or more of the shares of the Fund present (in person or by proxy) and entitled to vote at such meeting, if the holders of more than 50% of the outstanding shares of the Fund entitled to vote at such meeting are present in person or by proxy, or (b) of the holders of more than 50% of the outstanding shares of the Fund entitled to vote at such meeting, whichever is less.

For the purposes of this agreement, "interested person" shall have the meaning defined in the Investment Company Act of 1940, as in force at the time, or in any act amendatory thereof or in substitution therefor, as in force at the time.

For the purposes of this agreement, "assignment" shall have the meaning defined in the Investment Company Act of 1940, as in force at the time, or in any act amendatory thereof or in substitution therefor, as in force at the time.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be duly executed the day and year first above written.

AMERICAN INVESTORS FUND, INC.
By GEORGE A. CHESTNUTT, JR.
President

Attest:

DOUGLAS M. CRAM
Secretary

CHESTNUTT CORPORATION
By GEORGE A. CHESTNUTT, JR.
President

Attest:

DOUGLAS M. CRAM
Secretary

Exhibit 2

GALFAND v. CHESTNUT

73 Civ. 3849 (CLB)

EXHIBIT PREPARED
PURSUANT TO COURT'S DECISION
AND DIRECTIONS RELATING TO
EXPENSE RATIO COMPUTATION
FOR PORTION OF 1974

Defendants, without admitting any liability and for the sole purpose of assisting the Court and following the Court's determination of liability, submit the following facts based upon matters already in the record and upon the detailed information annexed and in accordance with the further exhibits hereinafter referred to.

1. As per published audited statements:

   $ 806,980—first six months' 1974 expenses; minus
   –641,159—second six months' 1974 expenses.

   $ 165,821—excess of first six months expenses over second six months' expenses.

2. $ 806,980—first six months' expenses per statement, minus
   – 6,776—interest and taxes.

   $ 800,204—first six months' expenses per statement, exclusive of interest and taxes.

3. In July and August 1974 the Fund incurred taxes of $1,933.

4. $ 641,159—second six months' expenses per statement; minus
   - 4,500—taxes; minus
   - 1,337—interest;

   $ 635,322—expenses per second six months' statement exclusive of interest and taxes.

5. In the four-month period September 1, 1974 through December 31, 1974, the Fund incurred interest and taxes of $3,904.

6. The first six months' figure of expenses amounting to $800,204 (exclusive of interest and taxes) included an amount of $2,400 in connection with extraordinary expense incurred in the program of small shareholder redemptions.

7. In the first eight months of 1974 the extraordinary expenses paid in connection with the small shareholder redemptions was
   $6,982.79, of which
   -2,400.00 was paid in the first six months and

   $4,582.79 was paid in the two months of July and August 1974.

8. Total extraordinary expenses for small shareholder redemptions were
   $59,585.99, less
   - 6,982.79—paid in first eight months

   $52,603.20—amount paid in last four months of year.

9. In the second six months of 1974 the extraordinary expense of the small shareholder program was $57,185.99, after the $2,400 paid in the first six months of the year.

10. Expenses per statements (exclusive of interest and taxes) were:

$ 800,204 for the first six months, less
–635,322 for the second six months

$ 164,882—difference between the two periods.

11. The second six months expenses per statement (exclusive of interest and taxes) were:

$635,322.00, less extraordinary expenses for small shareholder redemptions of
– 57,185.99

$578,136.01—second six months' expenses per contract.

The difference between the first six months and the second six months, after excluding the second six months' extraordinary expenses for small shareholder redemptions, shows

$800.204.00—first six months' expenses exclusive of interest and taxes, less
–578,136.01—second six months' expenses exclusive of interest, taxes and extraordinary expense.
$222,067.99—difference between the two periods.

12. Expenses paid in July and August 1974 (exclusive of expenses already accrued for the prior six months' audited period and exclusive of interest and taxes) were:

July	$10,415.33
August	33,496.87*
Total	$43,912.20
Adding the	$800,204.00 for the first six months

(exclusive of interest and taxes) shows eight months' expenses of $844,116.20—total expenses for eight-month period.

13. The average of the total net assets for the Court-defined eight-month period computed in accordance with filings with the SEC, the Fund's invariable practice and its audited statements for many years was $130,481,248, of which a 1% expense limitation was $1,304,812, which limitation exceeded the eight months' expenses by $460,695.80.

Even if it were assumed that for the eight-month period the limitation was 8/12 of 1%, the limit would be $869,875, exceeding actual expenses by $25,758.80.

14. $39,068.73 was accrued or paid in the third quarter of 1974 as extraordinary expenses in connection with the small shareholder redemption program, of which

– 4,582.79 was disbursed in July and August,

leaving a balance of
$34,485.94 which was included in expenses in the third quarterly statement sent to shareholders.

* An additional amount of $109.50 should have been excluded as either interest or taxes.

15. In October 1974 pursuant to a new, unassailed, and admittedly valid contract, an investment advisory fee of $157,276.87 was paid. Interest of $1,228 was paid in the third quarter. Taxes in the third quarter were $2,900 (of which $1,933 was incurred in July and August).

Small shareholder redemptions, and extraordinary expense under the new and admittedly valid agreement, amounted to
$39,068.73, of which

– 4,582.79 had been paid in July and August and constituted part of the $43,912 disbursements above referred to, and consequently

$34,485.94 paid or accrued in September 1974 is excluded from the Fund's expense ratio computation.

The difference between the expenses shown on the first six months' statement, and the expenses shown on the third quarterly statement is
$329,896.00, minus

–157,277.00—advisory fee paid in October 1974;

$172,619.00—other expenses, minus
– 4,128.00—interest and taxes;

$168,491.00, minus
– 34,485.94—extraordinary expenses for small shareholder redemption;

$134,005.06, minus
– 43,912.00—disbursements in July and August;

$ 90,093.06—remainder of expenses.

16. No portion of the "remainder" of expenses of $90,093.06 (or any amount other than the amount of $844,116.20 above mentioned) ever had any impact on the Fund, upon plaintiff, or upon any other shareholder on or prior to September 1, 1974. The Fund bore no burden, in whole or in part, of such amount until subsequent to September 1, 1974.

17. Even were plaintiff to have redeemed her shares on the last day of August, 1974, neither she nor any other redeeming shareholder would have suffered any detriment for the reason that at all relevant times there were outstanding at least 29,000,000 of the Fund's shares. An accounting Regulation of the Securities and Exchange Commission (Reg. § 270.2a-4b) provides expenses of an investment company ". . . need not be so reflected if cumulatively, when netted, they do not amount to as much as 1 cent per outstanding share."

    One penny for each of 29,000,000 shares equals $290,000. It would require an increase of $290,000 in expenses in a single day to amount to any change whatsoever in the redemption price per share.

Annexed and incorporated herein are the detailed data of expenses upon which the foregoing is based, a copy of Reg. § 270.2a-4b, the instructions for Form N-1R, Part I of Form N-1R (exclusive of certain exhibits thereto) for the year 1972 showing the manner of computation by the Fund in accordance with SEC instructions.

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